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FM AMEMBASSY LONDON

TO TREASURY DEPT WASHDC IMMEDIATE

INFO SECSTATE WASHDC 8335

UNCLAS SECTION 01 OF 08 LONDON 19408

E.O. 11652: N/A

TAGS: EFIN, UK

SUBJECT: CHANCELLOR HEALEY'S STATEMENT TO PARLIAMENT ON
THE UK ECONOMY AND IMF BORROWING

1. WHAT FOLLOWS IS HANSARD (IE, OFFICIAL TEXT) REPORT OF
CHANCELLOR'S PRESENTATION TO PARLIAMENT ON NOVEMBER 30.

QUOTE

THE CHANCELLOR OF THE EXCHEQUER (MR. DENIS HEALEY): WHEN
WE LAST DEBATED THE ECONOMY ON 11TH OCTOBER, I DREW THE
ATTENTION OF THE HOUSE TO THE DETERIORATION IN THE WORLD
ECONOMY SINCE THE SUMMER. IN THE 7 WEEKS SINCE THEN, A
GROWING HARVEST OF ECONOMIC STATISTICS SHOWS THAT THE DI-
MENSION OF THAT DETERIORATION IS EVEN GREATER THAN
WE BELIEVED AT THAT TIME.

NOT ALL THE FIGURES FOR THE 3RD QUARTER ARE YET AVAIL-
ABLE, SO THERE IS SOME ROOM FOR A DIFFERENCE OF VIEW. BUT
IT ALREADY SEEMS CLEAR THAT, WHEREAS IN THE PREVIOUS 12
MONTHS INDUSTRIAL PRODUCTION IN THE OECD AREA AS A WHOLE
HAD BEEN RISING AT AN ANNUAL RATE OF ABOUT 10 PERCENT, IN
THE 3RD QUARTER OF THIS YEAR IT ROSE AT LESS THAN HALF

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THAT RATE, AND THERE HAS BEEN GROWING CONCERN AMONG GOV-

ERNMENTS AND INFORMED COMMENTATORS ALL OVER THE WORLD ABOUT THIS PAUSE IN RECOVERY.

THE PROSPECTS FOR EMPLOYMENT AND ACTIVITY ALL OVER THE WORLD NOW LOOK A GOOD DEAL WEAKER THAN THEY WERE THEN, AND THERE IS A COMMON CONCERN LEST THEY BE WEAKENED STILL FURTHER BY AN INCREASE IN THE PRICE OF OIL.

IF WE FOCUS OUR ATTENTION ON WESTERN EUROPE, THE PICTURE IS SEEN EVEN MORE CLEARLY. AS EUROVISION POINTS OUT IN ITS CURRENT NUMBER, INVESTMENT WAS BARELY GETTING UNDER WAY WHEN THE STOCK MARKETS FELL THROUGH THE FLOOR WHILE INTEREST RATES ALL AROUND EUROPE WENT THROUGH THE CEILING. THE BALANCE OF PAYMENTS OVER MOST OF EUROPE HAS NOW FALLEN INTO DEFICIT, AND THE LATEST FIGURES FOR UNEMPLOYMENT PUBLISHED BY THE EUROPEAN COMMISSION LAST WEEK SHOW UNEMPLOYMENT RISING IN BELGIUM, DENMARK, GERMANY AND FRANCE. IN BRITAIN, ALTHOUGH UNEMPLOYMENT SEEMS RECENTLY TO HAVE LEVELLED OFF, THE PROSPECT, AS THE PRIME MINISTER TOLD THE HOUSE LAST WEEK, IS FOR SOME FURTHER INCREASE IN THE COMING YEAR. MANY OTHER COUNTRIES ALL OVER THE WORLD FACE A SIMILAR PROSPECT.

THERE MUST STILL BE DEEP UNCERTAINTY ABOUT THE PROSPECTS FOR WORLD GROWTH IN THE NEXT 12 MONTHS, ALTHOUGH THE GENERAL VIEW IS THAT RECOVERY WILL RESUME, THOUGH AT A LOWER PACE THAN EXPECTED LAST SUMMER. BUT THERE IS UNIVERSAL AGREEMENT THAT SIGNIFICANT GROWTH WILL NOT TAKE PLACE IN THE REST OF THE WORLD UNLESS THE THREE STRONGEST ECONOMIES --THE UNITED STATES, GERMANY AND JAPAN--TAKE THE LEAD. FORTUNATELY, THIS RESPONSIBILITY IS RECOGNISED IN THE 3 COUNTRIES CONCERNED. THEY DO NOT SHARE THE VIEW EXPRESSED BY THE RIGHT HON. AND LEARNED MEMBER OF SURREY, EAST (SIR G. HOWE) THAT IT IS POSSIBLE TO PURSUE NATIONAL INTEREST WITH NO REGARD FOR THE WELFARE OF THE WORLD IN WHICH ONE'S NATION HAS TO LIVE.

I STRESS THE INTERNATIONAL CONTEXT WITHIN WHICH BRITAIN'S ECONOMY MUST OPERATE, BECAUSE IT MUST SET THE FRAMEWORK WITHIN WHICH OUR OWN PERFORMANCE MUST BE JUDGED AND FIX THE LIMITS WITHIN WHICH IT CAN BE IMPROVED. IT IS NOW POSSIBLE TO SEE MORE CLEARLY THE SHAPE OF THE SUMMER PAUSE IN OUR RECOVERY. WE LOOKED TO EXPORTS FOR THE MAIN INCREASE IN DEMAND, BUT THE VOLUME OF OUR EXPORT UNCLASSIFIED

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FELL 3 PERCENT IN THE 3RD QUARTER AS A WHOLE, ALTHOUGH THERE HAS BEEN SOME RECOVERY IN THE PAST 2 MONTHS. IMPORT REMAINED ABOUT CONSTANT. INDUSTRIAL PRODUCTION FELL BY ABOUT 1/2 PERCENT.

OUR GROSS DOMESTIC PRODUCT WAS SUSTAINED IN THE 3RD QUARTER BY SOME RISE IN CONSUMPTION FOLLOWING THE PAYMENT OF THE INCOME TAX REBATES AND A LEVELLING OUT OF THE DECLINE IN STOCK BUILDING. NEVERTHELESS, IN BOTH THE 2ND

AND 3RD QUARTERS OF THIS YEAR, OUR GROSS DOMESTIC PRODUCT APPEARS TO HAVE BEEN RISING AT A RATE OF UNDER 2 PERCENT A YEAR.

SOME SPECIAL FACTORS PLAYED THEIR PART. THE SUMMER WEATHER AND CHANGES IN HOLIDAY PATTERNS AFFECTED PRODUCTION IN SOME INDUSTRIES, AND THE INSTALLATION OF NORTH SEA EQUIPMENT DURING THE SUMMER KEPT UP IMPORT VOLUMES. NEVERTHELESS, IT IS DIFFICULT, EVEN GIVEN THE SLOWDOWN IN

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FM AMEMBASSY LONDON

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WORLD RECOVERY, TO EXPLAIN WHAT HAPPENED TO OUR EXPORTS SINCE THEY HAVE NEVER BEEN MORE COMPETITIVE AND PROFITABLE FOR BRITISH MANUFACTURERS. THIS IS RECOGNISED BY THE CBI AND EVERY MANUFACTURING FIRM IN THE COUNTRY.

MR. NICHOLAS RIDLEY (CIENCESTER WG TEWKESBURY): THE CHANCELLOR WILL RECALL THAT IN THE LAST PUBLIC EXPENDITURE WHITE PAPER HE BASED HIS PLANS FOR SPENDING ON A 3.5 PERCENT AVERAGE GROWTH RATE. NOW THAT HE HAS ADMITTED THAT IT IS 2 PERCENT OR SLIGHTLY UNDER, HAS HE SIMILARLY CUT HIS PLANS FOR PUBLIC SPENDING?

MR. HEALEY: I THINK THAT THE HON. GENTLEMAN WAS AWAKE ONCE OR TWICE DURING OUR DEBATES IN THE PAST YEAR, AND HE WILL KNOW THAT LAST JULY WE REVISED OUR PLANS FOR PUBLIC SPENDING.

IT MAY BE THAT OFFICIAL STATISTICS EXAGGERATE THIS FAILURE, SINCE THEY ARE NOT EASILY RECONCILED WITH EVIDENCE COLLECTED BY THE CBI FROM ITS MEMBERS, BUT IT WOULD BE UNWISE TO BANK ON THAT. UNFORTUNATELY IT IS DIFFICULT TO ESTIMATE THE NATURE OF OUR EXPORT PERFORMANCE IN UNCLASSIFIED

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THE COMING YEAR WHILE WE ARE STILL UNCERTAIN ABOUT THE NATURE AND CAUSES OF OUR POOR PERFORMANCE DURING THE SUMMER. THIS IS ONE OF THE MANY UNCERTAINTIES WHICH, AS I HAVE TOLD THE HOUSE BEFORE, MAKE ECONOMIC FORECASTING AS UNRELIABLE AS LONG-RANGE WEATHER FORECASTING.

ON THE OTHER HAND, ON TOP OF THE INCREASE IN EMPLOYMENT IN MANUFACTURING INDUSTRY WHICH BEGAN IN THE SUMMER--IT WENT UP OVER 60,000 BETWEEN THE 2ND AND 3RD QUARTERS OF THIS YEAR--THE LATEST FIGURES SUGGEST THAT CAPITAL SPENDING BY MANUFACTURING INDUSTRY HAS ALSO BEGUN TO IMPROVE. INVESTMENT BY MANUFACTURING INDUSTRY ROSE ABOUT 2 PERCENT BETWEEN THE 2ND AND 3RD QUARTERS OF THIS YEAR AND SPENDING IS NOW ALMOST 3 PERCENT ABOVE THE LOW POINT DURING THE 1ST QUARTER.

THE PROSPECT FOR THE FUTURE IS BRIGHTER STILL. IN ITS MOST RECENT ECONOMIC REPORT, ON THE BASIS OF INFORMATION COLLECTED AFTER THE SHARP RISE IN INTEREST RATES, THE CBI--A BODY WHICH HON. MEMBERS OPPOSITE REGULARLY SMEAR--FORECAST A RISE OF 15 PERCENT NEXT YEAR.

IN OTHER RESPECTS, HOWEVER, THE OUTLOOK FOR 1977 REMAINS EXCEPTIONALLY UNCERTAIN, AS IS DEMONSTRATED BY THE WIDE RANGE OF PROJECTIONS IN SOME OF THE PUBLISHED UNOFFICIAL FORECASTS. THE RIGHT HON. AND LEARNED GENTLEMAN REFERRED TO SOME OF THEM. ONLY ONE THING IS FAIRLY CERTAIN--LOWER GROWTH THAN WAS EXPECTED LAST JULY.

THE DEPRECIATION OF STERLING SINCE THE SUMMER WILL KEEP INFLATION AT SOMETHING LIKE ITS PRESENT LEVEL WELL INTO THE COMING YEAR AND THIS, IN ITSELF, WILL TEND TO DEPRESS HOME DEMAND. MOREOVER, ALTHOUGH WE CAN EXPECT THE LAGGED EFFECT OF DEPRECIATION TO PRODUCE A SUBSTANTIAL IMPROVEMENT IN EXPORTS AND IMPORT SUBSTITUTION NEXT YEAR, IF WORLD TRADE FAILS TO GROW AT THE RATE FORECAST EARLIER IN THE YEAR, EXTERNAL DEMAND IS ALSO LIKELY TO BE LOWER THAN EXPECTED. TOGETHER, THESE FACTORS MAKE IT LIKELY THAT, UNLESS WORLD TRADE IMPROVES, THE GROWTH IN OUR GDP NEXT YEAR MAY BE ONLY HALF AS HIGH AS WE EXPECTED IN JULY.

BUT IT IS DIFFICULT TO ESTIMATE THE PRECISE EFFECTS OF

LOWER GROWTH ON OTHER ELEMENTS IN THE ECONOMY. THE RIGHT
HON. AND LEARNED GENTLEMAN ASKED ME TO GIVE SOME VIEWS ON
THIS. FOR EXAMPLE, THE NATIONAL INSTITUTE IN ITS LATEST
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ECONOMIC REVIEW, WHILE ASSUMING LOWER GROWTH NEXT YEAR
THAN MOST OTHER FORECASTS, BELIEVES THAT UHEMPLOYMENT IS
UNLIKELY TO ISE IN CONSEQUENCE BECAUSE THERE WILL BE MUC
MORE WORK SHARING AND THUS THAT PRODUCTIVITY WILL NOT RIS
AT ITS TREND RATE--IF IT RISES AT ALL. THIS IS ONE REASO
WHY ITS FORECAST OFQSBR NEXT YEAR IS A GOOD DEAL LOW-
ER THAN OTHERS WOULD ASSUME ON THESAME ASSUMPTIONS--ALTH-
OUGH THE NATIONAL INSTITUTE ADMITS THAT NOTUCH ATTENTION
SHOULD BE PAID TO ITS PSBR FORECAST.

AT THE SAME TIME THE NATIONAL INSTITUTE ASSUMES A
MUCH GREATER IMPROVEMENT IN THE TERMS OF TRADE THAN IS
EASILY EXPLAINED. SO IT FORECASTS A SUBSTANTIAL AND GROW-
ING SURPLUS ON THE BALANCE OF PAYMENTS, AND ARGUES AGAINST
ANY RESORT TO TEMPORARY IMPORT RESTRICTIONS TOHASTEN THE
RETURN TO CURRENT BALANCE.

I HAVE REFERRED TO THE NEW FORECAST BY THE NATI-
ONAL INSTITUTE TO ILLUSTRATE THE EXCEPTIONAL UNCERTAINTY
OF THE OUTLOOK FOR THECOMING YEAR AND THE FRAGILITY OF
THE ASSUMPTIONS WHICH FORECASTERS ARE OBLIGED TO MAKE.
BUT, AS I HAVE SAID, THERE CAN BE LITTLE DOUBT THAT DE-
MAND AT HOME AND ABROAD WILL BE SUBSTANTIALY LTWE NEXTYEAR THAN ANYONE
WOULD HAVE EXPECTED A FEW MONTHS AGO AND

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FM AMEMBASSY LONDON

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THAT OUTPUT WILL THEREFORE BE LOWER, TOO.

AGAINST THIS BACKGROUND, THERE HAS BEEN A WELCOME CHANGE IN THE TONE OF SOME AT LEAST OF THE GOVERNMENT'S CRITICS. A FEW NEWSPAPERS ARE STILL ASKING FOR A MASSIVE FURTHER DEFLATION OF THE ECONOMY THROUGH CUTS IN PUBLIC EXPENDITURE OF AT LEAST 5 BILLION POUNDS IN THE COMING YEAR, BUT I NOTICE A SIGNIFICANT CAUTION IN THE RIGHT HON. AND LEARNED GENTLEMAN'S SPEECH ON THAT POINT THIS AFTERNOON, COMPARED WITH SOME OF THE SPEECHES TO WHICH HE TREATED US EARLIER THIS YEAR. AS I POINTED OUT IN MY SPEECH AT THE MANSION HOUSE LAST MONTH, A MASSIVE AND IMMEDIATE DEFLATION OF THIS NATURE WOULD BRING A FALL IN LIVING STANDARDS OF SOME 10 PERCENT OR MORE, GENERATED LARGELY BY AN INCREASE IN RETAIL PRICES, AND WOULD REDUCE OUR NATIONAL OUTPUT BY SOME 5 PERCENT COMPARED WITH WHAT IT WOULD OTHERWISE HAVE BEEN. IT WOULD MEAN A MASSIVE INCREASE IN UNEMPLOYMENT. I ASK THE HOUSE WHAT I ASKED MY CITY AUDIENCE ON THAT OCCASION. HOW MANY HON. MEMBERS, APART FROM THE RIGHT HON. MEMBER FOR LEEDS, NORTH EAST (SIR. K. JOSEPH), REALLY BELIEVE THAT THIS COULD HAPPEN WITHOUT WIDESPREAD INDUSTRIAL DISRUPTION, A WAGE UNCLASSIFIED

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EXPLOSION AND A COLLAPSE IN CONFIDENCE THROUGHOUT THE ECONOMY?

I AM GLAD TO SEE THAT SOME OF THE GOVERNMENT'S CRITICS AT ANY RATE HAVE NOW BECOME MORE MODERATE IN THEIR DEMAND AND IN THIS THEY ARE ECHOED BY BOTH SIDES OF INDUSTRY. INDEED THE NEW DIRECTOR GENERAL OF THE CBI HAS MADE IT CLEAR THAT HIS ORGANISATION DOES NOT SUPPORT THE CALLS FOR FURTHER DEFLATION. IT WANTS MEASURES WHICH WOULD HAVE A BROADLY NEUTRAL EFFECT ON DEMAND. THE CBI PUT THIS POINT STRONGLY TO ME WHEN WE MET IN THE TREASURY LAST FRIDAY.

WHAT IS NEEDED AT THE PRESENT CRITICAL MOMENT IN BRITAIN IS A PROGRAMME WHICH WILL BRING THE ECONOMY INTO BALANCE AT A PACE WHICH WILL NOT OVERSTRAIN THE NATIONAL CONSENSUS ON WHICH ALL HOPE OF INDUSTRIAL PROGRESS AND RECOVERY MUST DEPEND. WE MUST THINK IN TERMS OF A

STABILISATION PROGRAMME COVERING AT LEAST 2 YEARS, PERHAPS THREE. IF THIS IS THE MEANING OF THE LIBERAL PARTY'S AMENDMENT, THEN I WELCOME IT.

THE IMMEDIATE PROBLEM, HOWEVER, IS TO REGAIN CONTROL OF THE POUND STERLING. AS I POINTED OUT IN THE LAST DEBATE THERE HAS BEEN IN RECENT MONTHS A CONTINUOUS AND MALIG-NANT INTERACTION BETWEEN EXPECTATIONS ABOUT THE GROWTH IN THE MONEY SUPPLY AND MOVEMENTS IN THE EXCHANGE RATE. IT IS NO USE REGARDING SUCH FINANCIAL OR MONETARY FACTORS AS SOMEHOW IRRELEVANT TO THE REAL ECONOMY. THAT WAS THE TRAGIC ERROR MADE BY THE LAST GOVERNMENT, AS I THINK MOST OF THEIR SURVIVORS WOULD NOW AGREE.

THE PAINFUL MEASURES WHICH THE GOVERNMENT TOOK LAST MONTH TO TIGHTEN CREDIT ALREADY HAVE HAD A MARKED EFFECT ON THE GROWTH OF MONEY SUPPLY, ALTHOUGH EXCESSIVE BANK LENDING IN OCTOBER ROBBED US OF THE FULL EFFECT WE COULD OTHERWISE HAVE EXPECTED FROM THE MASSIVE SALES OF GILTS WHICH FOLLOWED. THAT IS WHY WE DECIDED A FORTNIGHT AGO TO REINTRODUCE THE SUPPLEMENTARY SPECIAL DEPOSITS SCHEME AND TO END THE PROVISIONS UNDER WHICH BANKS IN BRITAIN ARE ABLE TO LEND MONEY FOR FINANCING TRADE BETWEEN THIRD COUNTRIES. BESIDES MAKING MORE CREDIT AVAILABLE FOR BRITISH INDUSTRY WITHIN THE STRICT LIMITS NOW SET ON BANK ADVANCES, THE LATTER MEASURE IS EXPECTED TO BRING A GAIN OF SOME 500 MILLION POUNDS TO OUR CAPITAL ACCOUNT IN THE COMING YEAR.

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BUT THE FOUNDATION OF ANY PROGRAMME FOR STABILISING OUR ECONOMY MUST BE THE REESTABLISHMENT OF CONFIDENCE IN STERLING. WE HAVE SEEN A USEFUL IMPROVEMENT HERE OVER THE LAST FEW WEEKS, AND I DOUBT WHETHER THIS IS DUE TO THE DELIVERY, BOUND AND GAGGED, OF THE HON. MEMBER FOR BLABY (MR. LAWSON) TO THE OPPOSITION WHIPS' OFFICE).

I BELIEVE THAT THE SUCCESSFUL CONCLUSION OF OUR APPLICATION FOR FURTHER FACILITIES FROM THE INTERNATIONAL MONETARY FUND WILL CONSOLIDATE THAT IMPROVEMENT, PARTICULARLY IF IT IS ACCOMPANIED, OR FOLLOWED CLOSELY, BY AN INTERNATIONAL AGREEMENT TO DEAL WITH THE PROBLEMS CREATED BY OUR STERLING BALANCES.

MR. TIM RENTON (MID-SUSSEX) DOES THE CHANCELLOR AGREE THAT THE EFFECT OF THE APPLICATION IS LIKELY TO BE A CORSET WHICH WILL BE SO TIGHT THAT THERE WILL BE ONLY A 1 TO 2 PERCENT GROWTH IN THE BANKS' ELIGIBLE LIABILITIES OVER THE NEXT 5 MONTHS? THEREFORE, PRIVATE INDUSTRY MAY FIND ITSELF VERY SHORT OF CAPITAL BORROWINGS FROM THE BANKS IN THE NEXT YEAR OR SO. SECONDLY, HAS HE MADE ANY ESTIMATE OF THE LOSS OF INVISIBLE EARNINGS AS A RESULT OF THE MEASURES DESIGNED NOT TO USE STERLING FOR TRADE WITH

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FM AMEMBASSY LONDON

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THIRD COUNTRIES?

MR. HEALEY: ON THE FIRST QUESTION, I AGREE THAT IT WILL BE RESTRICTIVE, BUT THE ENDING OF THE FACILITY FOR FINANCING TRADE WITH THIRD COUNTRIES MEANS THAT THAT AMOUNT MORE WILL BE AVAILABLE FOR INDUSTRIAL LENDING. VERY STRICT INSTRUCTIONS HAVE BEEN ISSUED TO THE PRIVATE BANKS TO GIVE PRIORITY TO INDUSTRIAL LENDING. A SMALL INCREASE IN MANUFACTURING INDUSTRY THIS YEAR HAS BEEN SHOWN ALREADY IN THE FIGURES I HAVE GIVEN. IT IS NOT POSSIBLE TO MAKE AN ASSESSMENT OF THE LOSS OF INVISIBLE EARNINGS NEXT YEAR, BUT IT IS POSSIBLE TO ESTIMATE THE GAIN TO OUR BALANCE OF PAYMENTS. THIS IS EXPECTED TO BE 500 MILLION POUNDS, WHICH IS VERY WORTHWHILE IN THE PRESENT SITUATION.

THE HOUSE WILL NOT EXPECT ME TO COMMENT THIS AFTERNOON ON THE DISCUSSIONS WHICH ARE TAKING PLACE WITH THE FUND STAFF. BUT IT MAY BE USEFUL IF I DESCRIBE THE SPIRIT IN WHICH THE DISCUSSIONS ARE TAKING PLACE AND THE

FRAMEWORK OF POLICY ESTABLISHED FOR THE DECISIONS WHICH
THE GOVERNMENT WILL TAKE.
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FIRST LET ME GIVE THE LIE TO SOME OF THE FEVERISH
IMAGININGS WHICH HAVE FILLED THE RECENT PAGES OF SOME
NEWSPAPERS WHICH HAVE NO OBJECTIVE BUT TO BRING THE LABOUR
GOVERNMENT DOWN BY FAIR MEANS OR FOUL.

THERE IS NO QUESTION OF THE INTERNATIONAL MONETARY
FUND SEEKING TO IMPOSE ON BRITAIN A MASSIVE DOES TF DE-
FLATION SUCH AS SOME OF OUR OWN NEWSPAPERS--AND I SUSPECT
THE CONSERVATIVE PARTY, ARE DEMANDING. NOR IS THERE ANY
QUESTION OF THE FUND SEEKING TO FORCE A FUNDAMENTAL CHANGE
IN THE DIRECTION OF THE PRESENT GOVERNMENT'S POLICY. ON
THE CONTRARY, WE HAVE BEEN ASSURED AGAIN AND AGAIN THAT
THE BASIC THRUST OF OUR POLICY IS RIGHT--TO BASE OUR RE-
COVERY ON EXPORTS AND INVESTMENT, NOT ON AN AR-
TIFICIAL BOOST TO DOMESTIC CONSUMPTION LIKE THAT BROUGHT
ABOUT BY THE LAST GOVERNMENT IN 1972 AND 1973. MOREOVER
THE FUND AGREES WITH THE GOVERNMENT THAT, PROVIDING OUR
INDUSTRY TAKES ADVANTAGE OF THE COMPETITIVITY GIVEN IT AT
HOME AND ABROAD BY THE RECENT DEPRECIATION OF THE POUND,
OUR BALANCE OF PAYMENTS SHOULD BE IN SURPLUS ON CURRENT
ACCOUNT IN 1978. THE PURPOSE OF THE FUND DRAWING FOR
WHICH WE HAVE APPLIED IS TO HELP IN FINANCING OUR EXTERNAL
DEFICIT UNTIL THAT TIME COMES. IT IS, IF ONE LIKES. A
BRIDGING LOAN.

MOREOVER, THE FUND GIVES MUCH MORE CREDIT TO THE
EFFORTS OF THE BRITISH GOVERNMENT AND PEOPLE THAN UNPATRI-
OTIC HON. MEMBER OPPOSITE. I WAS ASKED BY ONE OF MY EUR-
OPEAN COLLEAGUES THE OTHER DAY HOW I COULD EXPLAIN THE BE-
HAVIOUR AND ATTITUDE OF THE OPPOSITION AT A TIME WHEN THE
BRITISH GOVERNMENT ARE NEGOTIATING WITH THE FUND. I FOUND
THAT QUITE EASY TO EXPLAIN.

MR. MICHAEL GRYLLS (SURREY, NORTHWEST): IS THE CHANCELLOR
TELLING THE HOUSE THAT THE IMF HAS TOLD HIM THAT THE GOV-
ERNMENT'S ECONOMIC POLICIES ARE RIGHT? IS HE SAYING
THAT THERE WILL NOT BE ANY MORE CUTS IN PUBLIC EXPENDITURE AM NOT SAYING
THAT. I AM COMING TO THAT
IN A MOMENT.

MOREOVER, THE FUND GIVES THE SAME IMPORTANCE AS THE
GOVERNMENT TO THE TWO PILLARS ON WHICH OUR ECONOMIC POLICY
IS BASED--THE SOCIAL CONTRACT WITH THE TRADE UNION MOVE-
MENT WHICH HAS GIVEN US ONE OF THE LOWEST INCREASES IN
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WAGE COSTS IN THE WORLD AND HAS BROUGHT ABOUT A DRAMATIC TRANSFORMATION IN INDUSTRIAL RELATIONS; AND THE INDUSTRIAL STRATEGY THROUGH WHICH THE GOVERNMENT, THE TRADE UNIONS AND THE EMPLOYERS ARE SEEKING TO IMPROVE THE PERFORMANCE OF OUR MANUFACTURING INDUSTRY.

I HAVE HEARD NO ECHO IN ANY OF MY DISCUSSIONS WITH THE FUND OF THE VIEW SO LOUDLY TRUMPETED BY THE CONSERVATIVE PARTY THAT THE SOCIAL CONTRACT IS A FOOL'S BAGGAGE. QUITE THE REVERSE, THEY REGARD IT AS THE KEYSTONE TO OUR RECOVERY AND HAVE ALREADY RECOMMENDED OTHER COUNTRIES TO FOLLOW OUR EXAMPLE. INDEED, THE SOCIAL CONTRACT AND THE INDUSTRIAL STRATEGY TOGETHER ARE THE ONLY BASES ON WHICH BRITAIN CAN HOPE TO RECEIVE THOSE STRUCTURAL IMPROVEMENTS IN HER ECONOMY TO WHICH CONGRESSMAN REUSS, CHAIRMAN OF THE HOUSE COMMITTEE ON FINANCE, REFERRED SO RIGHTLY IN HIS RADIO INTERVIEW LAST NIGHT.

AGAIN THE FUND RECOGNISE THE IMMENSE PROGRESS WHICH HAS BEEN MADE BY THE TREASURY IN THE LAST 12 MONTHS IN ESTABLISHING EFFECTIVE CONTROL OF PUBLIC EXPENDITURE AND OUR DETERMINATION TO MAKE THE LIMITS STICK. THEIR CONCERN, LIKE THAT OF THE GOVERNMENT, IS THAT THE PROBLEMS OF FINANCING

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FM AMEMBASSY LONDON

TO TREASURY DEPT WASHDC IMMEDIATE

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OUR EXTERNAL AND INTERNAL DEFICITS SHOULD NOT AGAIN DISTURB OUR STEADY PROGRESS TOWARDS OUR GOAL AS IT HAS DONE IN THE LAST 6 MONTHS; BUT THEY DO NOT BELIEVE, AS SOME OF THE DOMESTIC CRITICS OF THE GOVERNMENT APPEAR TO DO, THAT THE ACHIEVEMENT OF FINANCIAL BALANCE IS POSSIBLE AT ONCE. THEY RECOGNISE THAT WE NEED A 2 OR EVEN 3 YEAR STABILISATION PROGRAMME--ALTHOUGH THEY WOULD NOT BE SO AMBITIOUS AS TO PRETEND THAT FORECASTING OVER A 3-YEAR PERIOD IS ACCURATE ENOUGH TO PERMIT THE PROGRAMME FOR THE LAST YEAR TO BE DRAWN EXCEPT IN THE BROADEST ORDER OF MAGNITUDE.

FINALLY, AND HERE AGAIN, WE ARE AT ONE WITH THE FUND STAFF, THEY ARE AS ANXIOUS AS WE ARE TO ENSURE THAT ANY ADJUSTMENTS ON WHICH WE NOW DECIDE SHOULD BE SUFFICIENT TO DO THE JOB, THAT WE SHOULD NOT HAVE TO TAKE ANOTHER BITE AT THE CHERRY. ON ALL THESE ISSUES THERE IS NO DIVISION BETWEEN THE GOVERNMENT AND THE INTERNATIONAL MONETARY FUND.

MR. NICHOLAS FAIRBAIRN (KINROSS & WEST PERTHSHIRE): IF, AS THE CHANCELLOR OF THE EXCHEQUER SAYS, THE FUND TAKES UNCLASSIFIED

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THE VIEW THAT HIS ECONOMIC POLICIES ARE CORRECT, HOW IS IT THAT THE MAJORITY OF THE CABINET APPARENTLY ARE AGAINST HIM AND THE FUND? IS IT THAT IT DOES NOT THINK THAT THE POLICIES ARE CORRECT AND THAT THE FUND IS WRONG? WHAT IS THE POSITION? IF THE FUND THINKS HE IS A GENIUS, WHY DO NOT THE REST OF THE CABINET SHARE THAT VIEW?

MR. HEALEY: THE HON. AND LEARNED MEMBER FOR KINROSS & WEST PERTHSHIRE (MR. FAIRBAIRN) NEVER CEASES TO ASTONISH ME OR, I SUSPECT, HIS RIGHT HON. AND HON. FRIENDS. I WOULD HAVE THOUGHT THAT AN HON. AND LEARNED MEMBER OF HIS VAST EXPERIENCE AND ACUTE INTELLIGENCE WOULD KNOW BETTER THAN TO BELIEVE STORIES WHICH HE READS IN CONSERVATIVE NEWSPAPERS.

MR. SKINNER: MY RIGHT HON. FRIEND HAS CAREFULLY EXPLAINED THE WAY IN WHICH THE NEGOTIATIONS HAVE TAKEN PLACE ABOUT THE MASSIVE CUTS IN PUBLIC EXPENDITURE. WHY DID HE SAY THAT THERE WOULD BE NO NEED FOR ANOTHER BITE AT THE CHERRY? WHEN HE TALKS ABOUT LOANS AS DISTINCT FROM ANOTHER CUT IN PUBLIC EXPENDITURE PER SE HE HAS FORCEFULLY EXPLAINED TO THE IMF THAT ANOTHER 100,000 ON THE DOLE WOULD, AT CURRENT PRICES, REPRESENT AN EXTRA 400 MILLION POUNDS

ON THE PUBLIC SECTOR BORROWING REQUIREMENT? THAT IS AN ENORMOUS SUM.

MR. HEALEY: MY HON. FRIEND MADE AN INTERESTING INTERVENTION WHICH HE WILL NO DOUBT EXPAND IF HE CATCHES MR. SPEAKER'S EYE LATER IN THE DEBATE. HIS LAST POINT WAS RELEVANT--THE EFFECT OF UNEMPLOYMENT ON THE PSBR. THE FUND RECOGNISES THAT IT WILL HAVE A POWERFUL EFFECT. ITS BROAD ESTIMATE IS THAT UNDER-CAPACITY WORKING AND UNEMPLOYMENT IN THE CURRENT YEAR IS RESPONSIBLE FOR BETWEEN 1/3 AND 1/4 OF OUR WHOLE PUBLIC SECTOR BORROWING REQUIREMENT. MOREOVER, ANY INCREASE IN THE PSBR NEXT YEAR OVER WHAT WE EXPECTED IN JULY--IF IT TAKES PLACE--WILL BE 3/4 DUE TO THE INCREASE IN UNEMPLOYMENT WHICH MIGHT FOLLOW THE LOWER GROWTH RATES.

BUT, AS I HAVE SAID, IT IS VERY DIFFICULT INDEED TO PREDICT HOW GROWTH WILL AFFECT UNEMPLOYMENT AT A TIME WHEN UNEMPLOYMENT IS ALREADY HIGH. AS MY HON. FRIEND
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KNOWS, THE NATIONAL INSTITUTE HAS ESTIMATED THAT ALTHOUGH GROWTH WILL FALL FURTHER NEXT YEAR THAN I BELIEVE IT WILL THERE WILL BE NO INCREASE IN UNEMPLOYMENT AT ALL. THAT IS THE REASON WHY THE NATIONAL INSTITUTE ESTIMATE SHOWS SUCH A LOW PSBR.

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AID-05 CIEP-02 SS-15 STR-04 ITC-01 USIA-15 PRS-01

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I NOW COME TO THE ISSUE ABOUT WHICH HON. MEMBERS ARE SO ANXIOUS. THE QUESTION WHICH REMAINS IS NOT ONE FOR THE IMF. IT IS FOR THE BRITISH GOVERNMENT ALONE TO DECIDE THE SIZE, NATURE AND PHASING OF THE ADJUSTMENTS REQUIRED TO BRING OUR ECONOMY INTO BALANCE IN TIME. WHEN WE HAVE TAKEN OUR DECISION, THE IMF WILL HAVE TO DECIDE WHETHER WE HAVE DECIDED WISELY. BUT THE DECISION IS SO IMPORTANT, AND THE PROBLEMS AND UNCERTAINTIES WE FACE IN TAKING IT ARE SO GREAT, THAT I MAKE NO APOLOGY FOR TAKING THE TIME REQUIRED TO GET IT RIGHT.

OTHER COUNTRIES ARE FINDING EXACTLY THE SAME DIFFICULTIES IN DECIDING WHAT ADJUSTMENTS SHOULD BE MADE TO MEET THE UNPRECEDENTED UNCERTAINTIES OF THE COMING YEAR. THAT IS PARTICULARLY TRUE OF THE COUNTRIES WHICH I MENTIONED EARLIER TO WHICH THE REST OF THE WORLD MUST LOOK I WE ARE TO ENSURE THAT THE WORLD RECOVERY DOES NOT SPEND ITS FORCE EVEN BEFORE IT IS PROPERLY UNDER WAY. I SPEAK OF THE UNITED STATES, GERMANY AND JAPAN. WE HAVE, HOWEVER, SOME SPECIAL PROBLEMS AND I WOULD LIKE TO MENTION SOME OF THEM. (INTERRUPTION) THE WIT ON THE BENCHES OPPOSITE ALMOST BAFFLES THE IMAGINATION.

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FIVE BALANCE OF PAYMENTS DEFICIT IN 1974 WHICH WAS THEREAFTER SWOLLEN BY THE STUPENDOUS INCREASE IN OIL PRICES. WE HAVE MADE SUBSTANTIAL PROGRESS ALREADY IN DEALING WITH THIS PROBLEM. BETWEEN 1973 AND 1975 BRITAIN TRANSFERRED 3 PERCENT OF ITS GDP INTO THE BALANCE OF PAYMENTS. BUT OVER THE SAME PERIOD THE DETERIORATION IN OUR TERMS OF TRADE CAUSED BY THE INCREASE IN OIL PRICES AND OF OTHER IMPORT PRICES WAS EQUIVALENT TO A SHIFT OF 2-1/2 PERCENT IN THE OTHER DIRECTION SO THE NET GAIN TO OUR BALANCE OF PAYMENTS OVER THAT PERIOD WAS EQUAL TO ONLY ABOUT 1/2 PERCENT OF OUR GROSS DOMESTIC PRODUCT.

IN SPITE OF THE DEPRECIATION OF STERLING, OUR TERMS OF TRADE HAVE BEEN FAIRLY STABLE SO FAR THIS YEAR. WHILE THIS CONTINUES WE SHALL GET THE FULL BENEFIT OF THE RESOURCES WE MANAGED TO SHIFT INTO THE BALANCE OF PAYMENTS. BUT WE HOPE TO SEE A SUBSTANTIAL INCREASE IN THE VOLUME OF

OUR EXPORTS OVER THE COMING YEAR -- THIS IS WHAT WE NEED TO GET UNEMPLOYMENT DOWN -- AND THIS IS LIKELY TO REQUIRE SOME REDUCTION IN THEIR RELATIVE PRICES WHICH COULD WELL BE AFFORDED OUT OF CURRENT PROFIT MARGINS.

MOREOVER, THERE ARE ALREADY SIGNS THAT THE LEVEL OF IMPORT PRICES IS AT LAST BEGINNING TO REFLECT THE RECENT DEPRECIATION OF THE POUND. WE SHALL PROBABLY SEE SOME DETERIORATION IN THE COMING YEAR AND HAVE TO SHIFT RATHER MORE RESOURCES INTO THE BALANCE OF PAYMENTS NEXT YEAR THAN INDICATED BY THE SIZE OF OUR CURRENT DEFICIT.

THE SECOND PROBLEM I SHOULD MENTION IS THE BALANCE BETWEEN PUBLIC EXPENDITURE AND TAXATION. IT IS NOW ACCEPTED BY OUR FRIENDS ABROAD THAT AS A PERCENTAGE OF GDP OUR PUBLIC EXPENDITURE IS WELL IN LINE WITH THAT OF OTHER COUNTRIES. THE NEW DEFINITIONS OF PUBLIC EXPENDITURE WHICH I HAVE RECENTLY ANNOUNCED AND WHICH THE SELECT COMMITTEE HAS ACCEPTED AS REASONABLE NOT ONLY MAKE FINANCIAL CONTROL A GOOD DEAL EASIER BUT ALSO BRING OUR DEFINITION MORE CLOSELY IN LINE WITH THAT USED BY OTHER COUNTRIES.

THE NEW TREATMENT OF NATIONALIZED INDUSTRY EXPENDITURE AND OF DEBT INTEREST, AS THE HOUSE KNOWS, GIVES OUR PUBLIC EXPENDITURE THIS YEAR AS 51.5 PERCENT OF GDP. BUT, MANY OTHER COUNTRIES APPEAR TO EXCLUDE FROM THEIR UNCLASSIFIED

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BUDGET FIGURES THAT PART OF SOCIAL SECURITY BENEFITS WHICH IS FINANCED BY CONTRIBUTIONS. IF WE DID THE SAME, OUR CURRENT TOTAL OF PUBLIC EXPENDITURE WOULD BE FURTHER REDUCED TO AROUND 45 PERCENT, AT FACTOR COST, AND IF, LIKE GERMANY, WE EXPRESSED OUR GDP AT MARKET PRICES, THEN THE CURRENT PERCENTAGE OF GDP TAKEN BY PUBLIC EXPENDITURE WOULD BE CLOSE TO ONLY 40 PERCENT.

SO THE PICTURE OF A PROFLIGATE PUBLIC EXPENDITURE AS IGNORANTLY PRESENTED BY PROFESSOR MILTON FRIEDMAN AND FATUOUSLY ECHOED BY THE CONSERVATIVE PARTY BEARS NO RELATION TO THE FACTS. INDEED, IN 1975, THE LAST YEARS FOR WHICH WE HAVE FIGURES, THE UNITED STATES SPENT 8.3 PERCENT OF ITS GNP AT MARKET PRICES ON SOCIAL SECURITY, COMPARED WITH 8 PERCENT FOR THE UNITED KINGDOM.

MR. JOHN NOTT (ST. IVES): IF PUBLIC EXPENDITURE IS AS PRUDENT AS THE CHANCELLOR OF THE EXCHEQUER MAKES OUT BY THESE NEW DEFINITIONS, WHY DO INTEREST RATES HAVE TO BE AT 15 PERCENT TO FINANCE IT.

MR. HEALEY: I AM DELIGHTED TO SEE THAT THE HON. MEMBER FROM ST. IVES (MR. NOTT) IS FOLLOWING THE ARGUMENT BECAUSE THAT IS THE NEXT POINT TO WHICH I AM ABOUT TO ADDRESS MYSELF. IT IS A PLEASURE TO KNOW THAT HE IS NOT SLEEPING

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H-02 INR-07 INT-05 L-03 LAB-04 NSAE-00 NSC-05 PA-02

AID-05 CIEP-02 SS-15 STR-04 ITC-01 USIA-15 PRS-01

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FM AMEMBASSY LONDON

TO TREASURY DEPT WASHDC IMMEDIATE

INFO SECSTATE WASHDC 8341

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DURING MY SPEECH IN THE WAY IN WHICH THE RIGHT HON.
MEMBER FOR SIDCUP (MR. HEATH) WAS SLEEPING DURING THE
SPEECH OF HIS RIGHT HON. FRIEND.

THIS IS ONLY HALF THE STORY. THE SENSIBLE CHANGES
THAT WE HAVE MADE IN PRESENTING THE FIGURES FOR PUBLIC
EXPENDITURE DO NOT IN THEMSELVES AFFECT THE ACTUAL SIZE
OF THE PUBLIC SECTOR BORROWING REQUIREMENT OR THE TAXA-
TION REQUIREMENT FOR WHICH PROVISION HAS TO BE MADE IN
THE BUDGET, SINCE THE BUDGET ARITHMETIC ALREADY TAKES AC-
COUNT OF THE SELF-FINANCING OF THE NATIONALISED INDUSTRIE
AND OF THE RECEIPTS WHICH CAN BE OFFSET AGAINST TOTAL
DEBT INTEREST PAYMENTS. THEREFORE, THE NEW DEFINITION OF
PUBLIC EXPENDITURE DOES NOT AFFECT THE PUBLIC SECTOR
BORROWING REQUIREMENT OR THE TAXATION REQUIREMENTS.

UNLESS WE ACTHYO REDUCE THE SIZE OF OUR PSBR WE ARE
LIKELY TO FIND THAT WE CAN FINANCE IT ONLY BY KEEPING IN-
TEREST RATES AT LEVELS WHICH, IF THEY PERSIST FOR ANY
LENGTH OF TIME, WILL GRAVELY DAMAGE OUR INDUSTRIAL STRAT-
EGY. ALSO, I MUST WARN THE HOUSE THAT IT IS IMPOSSIBLE
TO ESTABLISH A SIMPLE AND DIRECT RELATIONSHIP BETWEEN IN-
TEREST RATES AND THE PSBR AND INDUSTRIAL INVESTMENT,

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SINCE SO MUCH DEPENDS ON THE GENERAL STATE OF CONFIDENCE AT ANY TIME. ON THE OTHER HAND, IT IS IMMENSELY DIFFICULT TO FORECAST THE LIKELY SIZE OF THE PSBR SINCE, AS THE NATIONAL INSTITUTE POINTS OUT, IT IS THE RESIDUAL BETWEEN VERY LARGE FLOWS OF MONEY INDEED.

HOWEVER, IN THE MIDST OF ALL THIS UNCERTAINTY, I BELIEVE THAT THERE IS ONE THING THAT WE HAVE ALL LEARNED BY THE EXPERIENCE OF RECENT YEARS. AS THE PRIME MINISTER SAID AT BLACKPOOL. "WE USED TO THINK THAT YOU CAN JUST SPEND YOUR WAY OUT OF THE RECESSION AND INCREASE EMPLOYMENT BY CUTTING TAXES AND BOOSTING GOVERNMENT SPENDING." THAT WAS THE ROUTE TAKEN BY OUR PREDECESSORS IN 1973. I BELIEVE THAT THE PRIME MINISTER WAS RIGHT TO ADD THAT, "THAT OPTION NO LONGER EXISTS AND THAT IN SO FAR AS IT EVER DID EXIST, IT WORKED BY INJECTING INFLATION INTO THE ECONOMY AND EACH TIME THAT HAPPENED THE AVERAGE LEVEL OF UNEMPLOYMENT HAS RISEN."

WE MUST, THEREFORE, AIM AT A STEADY AND CONTINUOUS REDUCTION IN THE SIZE OF OUR PSBR. BUT THERE IS AT LEAST ONE FIELD IN WHICH THAT REDUCTION CANNOT BE SOUGHT -- AN INCREASE IN DIRECT TAXATION. I BELIEVE THAT THE LEVEL OF INCOME TAX IS ALREADY DANGEROUSLY HIGH AND IS ALREADY DOING REAL DAMAGE TO OUR ECONOMIC PERFORMANCE, PARTICULARLY THROUGH ITS EFFECT ON THOSE AT EACH END OF THE EARNINGS LADDER. THERE IS A VERY STRONG CASE FOR TACKLING THE PROBLEM OF THE OVERLAP BETWEEN WAGES AND BENEFITS. THE RIGHT HON. AND LEARNED GENTLEMEN ASKED ME TO EXPRESS A FEW THOUGHTS ON THIS MATTER. SO I SHALL.

AS I HAVE POINTED OUT ON MANY OCCASIONS, THE WHOLE BURDEN OF ECONOMIC SACRIFICE IS AT PRESENT BEING CARRIED BY THOSE IN WORK. THEY HAVE LIMITED THEIR WAGE INCREASES TO A LEVEL ONLY HALF AS HIGH AS INFLATION DURING THE PREVIOUS YEAR, AND THEY ARE TAXED ON THOSE INCREASES AT 35 PERCENT. THOSE ON BENEFIT HAVE BEEN PROTECTED AGAINST INFLATION BY THE AUTOMATIC INDEXING OF THEIR BENEFITS -- AND SHORT-TERM BENEFITS ARE NOT TAXED. THE RESULT OF THIS IS THAT TO GET 5 POUNDS MORE IN WORK THAN OUT OF WORK A MARRIED MAN NEEDS TO EARN MORE THAN 65 POUNDS A WEEK IF HE HAS TWO CHILDREN, AND MORE THAN 70 POUNDS A WEEK IF HE HAS FOUR. THERE ARE MANY PARTS OF THE COUNTRY, INCLUDING THAT WHICH I HAVE THE HONOUR TO REPRESENT, WHERE THE LEVELS OF

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EARNINGS ARE ABOVE THE AVERAGE.

I FEAR THAT THE CURRENT OVERLAP BETWEEN BENEFITS AND EARNED INCOME. BESIDES ITS DISINCENTIVE EFFECTON THOSE IN WORK, IS FUELING A BACKLASH AMONG THE LOW-PAID AGAINST THE WHOLE CONCEPT OF THE WELFARE STATE AND CREATING THE WHOLLY UNWARRANTED IMPRESSION THAT PEOPLE ON BENEFIT ARE IN SOME SENSE SCROUNGERS. IT GIVES ME NO PLEASURE TO RECORD THAT SOME CONSERVATIVE MEMBERS HAVE FELT IT RIGHT TO EXPLOIT THIS FEELING WITHOUT SHAME OR SCRUPLE. I THINK THAT THE WHOLE HOUSE SHOULD BE DISGUSTED WITH THEM.

ON THE OTHER HAND, I BELIEVE THAT THE SOCIAL AND POLITICAL IMPLICATIONS OF THIS BACKLASH SHOULD BE A REAL CAUSE FOR CONCERN ON BOTH SIDES OF THE HOUSE. IT IS ONE OF THE MANY REASONS FOR SEEKING TO REDUCE THE BURDEN OF DIRECT TAXATION. THIS IS ANOTHER OF THE MAJOR PROBLEMS WHICH THE GOVERNMENT MUST CONSIDER BEFORE THEY TAKE THEIR FINAL DECISION ON WHAT ADJUSTMENTS ARE REQUIRED TO MEET OUR CURRENT ECONOMIC SITUATION.

MR. SIDNEY BIDWELL (EALING, SOUTHALL): IF THE INTERNATIONAL MONETARY FUND IS NOT WORRIED ABOUT THE CURRENT LEVEL OF

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STR-04 ITC-01 USIA-15 PRS-01 SP-02 OMB-01 IGA-02 IO-13

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FM AMEMBASSY LONDON

TO TREASURY DEPT WASHDC IMMEDIATE

INFO SECSTATE WASHDC 8342

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PUBLIC EXPENDITURE IN BRITAIN, ESPECIALLY IN SO FAR AS IT AFFECTS SOCIAL SECURITY BENEFITS AND NATIONAL INSURANCE BENEFITS, WHY ARE WE MUCKING ABOUT WITH THE SOCIAL SECURITY (MISCELLANEOUS PROVISIONS) BILL ON THURSDAY, WHICH WILL LEAD TO DEPRIVING PENSIONERS AT THE AGE OF 60 OF THE RIGHT TO UNEMPLOYMENT PAY, WHICH FOR A YEAR INVOLV IN ALL, PROBABLY ABOUT 8 MILLION POUNDS NET? WHY ARE WE MUCKING ABOUT WITH MATTERS OF THAT KIND?

MR. HEALEY: THE GOVERNMENT ARE DEEPLY CONCERNED ABOUT THE SIZE OF THW PSBR. I MADE CLEAR IN JULY THE NECESSITY FOR THE DECISIONS THAT THE GOVERNMENT THEN ANNOUNCED, SOME OF WHICH HAVE STILL TO BE MADE OPERATIONAL THROUGH LEGISLATION. I PUT IT TO MY HON. FRIEND -- NO DOUBT I SHALL FIND OUT LATER HOW FAR HE AGREES WITH ME -- THAT TO REFUSE UNEMPLOYMENT BENEFIT TO THESE PARTICULAR CATEGORIES OF PEOPLE WHO GET SUPERANNUATION BENEFIT EARLY IS SOCIAL- LY BY FAR A LESS DAMAGING WAY OF SEEKING TO BRIDGE A LIT- TLE PART OF THIS GAP.

DECISIONS ON DIRECT TAXATION, OF COURSE, WILL BE POS- SIBLE ONLY IN THE SPRING BUDGET. MOREOVER, IT WILL BE IM- UNCLASSIFIED

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POSSIBLE TO TAKE SUCH DECISIONS UNTIL THE SHAPE OF THE THIRD PAY ROUND IS KNOWN. THE GOVERNMENT BELIEVES -- THE PRIMEMINISTER SAID SO THE OTHER DAY -- AND SO DOES THE TUC, WHICH STATED SO IN A COMPOSITE RESOLUTION PASSED AT ITS CONGRESS, THAT IT WILL BE ESSENTIAL TO CONTINUE TH ATTACK ON INFLATION AFTER THE SECOND PAY ROUND ENDS NEXT SUMMER IN WAYS WHICH WILL PERMIT GREATER FLEXIBILITY IN WAGE BARGAINING THAN HAS BEEN POSSIBLE IN THE FIRST TWO ROUNDS. I HOPE IT WILL BE POSSIBLE TO REACH DECISIONS ON THIS MATTER IN TIME FOR THEM TO BE REFLECTED IN THE INCOM TAX PROVISIONS OF THE NEXT BUDGET. MOREOVER, IF IN THE MEANTIME THE FIGURES SHOW THAT WE HAVE OVER-ESTIMATED THE SIZE OF THE ADJUSTMENT NEEDED TO BRING DOWN THE PSBR TO THE RIGHT LEVEL NEXT YEAR, THE NECESSARY DEMAND CAN BE FED BACK INTO THE ECONOMY BY INCOME TAX RELIEFS NEXT SPRING.

I HAVE TRIED TO GIVE THE HOUSE SOME IDEA OF THE WAY IN WHICH THEGOVERNMENT ARE APPROACHING THE PROBLEM THEY NOW FACE IN ADJUSTING THEIR ECONOMIC POLICY TO MEET THE CHANGES IN THE SITUATION WHICH WE NOW PERCEIVE. I DO NOT PRETEND THAT THESE ADJUSTMENTS WILL BE PAINLESS. ON THE CONTRARY. BUT I HOPE THAT I HAVE SAID ENOUGH TO INDICATE THAT SOME OF THE HORROR STORIES IN THE NEWSPAPERS RECENTL BEAR LITTLE RELATION TO THE TRUTH.

IN OUR APPROACH TO THESE DIFFICULT QUESTIONS, WE SHALL BE GUIDED ASALWAYS BY THE PARAMOUNT NEED TO GIVE

PRIORITY TO OUR MANUFACTURING INDUSTRY AND TO MAINTAIN TH
RELATIONSHIP WITH OUR TRADE UNIONS WHICH IS THE FOUNDATIO
OF SO MUCH THAT WE HAVE ACHIEVED SINCE WE TOOK OFFICE.

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: TEXT, ECONOMIC CONDITIONS, SPEECHES, FINANCIAL TRENDS
Control Number: n/a
Copy: SINGLE
Draft Date: 01 DEC 1976
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: n/a
Disposition Approved on Date:
Disposition Authority: n/a
Disposition Case Number: n/a
Disposition Comment:
Disposition Date: 01 JAN 1960
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1976LONDON19408
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D760445-0655
From: LONDON
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1976/newtext/t19761283/aaaacuih.tel
Line Count: 984
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EUR
Original Classification: UNCLASSIFIED
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 18
Previous Channel Indicators: n/a
Previous Classification: n/a
Previous Handling Restrictions: n/a
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: wolfsd
Review Comment: n/a
Review Content Flags:
Review Date: 25 MAY 2004
Review Event:
Review Exemptions: n/a
Review History: RELEASED <25 MAY 2004 by hattaycs>; APPROVED <13 AUG 2004 by wolfsd>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
04 MAY 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: CHANCELLOR HEALEY'S STATEMENT TO PARLIAMENT ON THE UK ECONOMY AND IMF BORROWING
TAGS: EFIN, UK, (HEALEY, DENIS)
To: TRSY
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006